

City and County of San Francisco

Office of the Controller - City Services Auditor

≡ Audit Division
≡ Audit Report

OFFICE OF THE TREASURER AND TAX COLLECTOR:

Financial Statements Audit of
the City Investment Pool
July 1, 2005, Through
June 30, 2006

DOCUMENTS DEPT.

JAN - 5 2007

SAN FRANCISCO
PUBLIC LIBRARY

FINANCIAL AUDITS



November 27, 2006





CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ed Harrington
Controller

Monique Zmuda
Deputy Controller

November 27, 2006

José Cisneros, Treasurer
Office of the Treasurer and Tax Collector
City Hall, Room 140
1 Dr. Carlton B. Goodlett Place
San Francisco, CA 94102-4638

Dear Mr. Cisneros:

The Office of the Controller presents its financial audit report of the Statement of Net Assets and Statement of Changes in Net Assets of the City and County of San Francisco (City) Investment Pool (Pool) held by the Office of the Treasurer and Tax Collector (Treasurer) as of June 30, 2006. These basic financial statements present the total cash and investments, and related activity under the control and accountability of the City's Treasurer.

We found that the basic financial statements referred to above present fairly, in all material respects, the financial position of the City's Pool as of June 30, 2006, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. We also found that the Treasurer complied with the investment requirements in the California Government Code, Sections 27130 through 27137, and with the City's investment policy.

Respectfully submitted,

Monique Zmuda for
Ed Harrington
Controller

Blank page intentionally inserted.



CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER
CITY SERVICES AUDITOR

Ed Harrington
Controller
Monique Zmuda
Deputy Controller

INDEPENDENT AUDITOR'S REPORT

San Francisco Board of Supervisors
City and County of San Francisco

We have audited the accompanying basic financial statements consisting of the Statement of Net Assets and the Statement of Changes in Net Assets of the City and County of San Francisco (City) Investment Pool (Pool) under the control and accountability of the Office of the Treasurer and Tax Collector (Treasurer) of the City and County of San Francisco as of June 30, 2006. These financial statements are the responsibility of the Pool's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements are intended to present the total cash on hand, cash in bank, investments, and related activity under the control and accountability of the Treasurer. They do not purport to, and do not, present fairly the financial position of the City and County of San Francisco as of June 30, 2006, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America. This report is intended for the purpose of providing information as required by Sections 26920(b) and 27134 of the California Government Code and Section 10.6-3 of the San Francisco Administrative Code. Our audit does not include an evaluation of the performance of the Treasurer's investment portfolio.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Pool as of June 30, 2006, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 6, a prior period adjustment is reported on the Statement of Changes in Net Assets to correct an error on the prior year financial statements. Accordingly, the net assets at the beginning of this fiscal year were reduced to correct the error.

FINANCIAL AUDITS

In accordance with *Government Auditing Standards*, we have also issued a report dated November 27, 2006, on our consideration of the Treasurer's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and the City's investment policy. The purpose of that report is to describe the scope of our testing on internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

However, because the City's Controller has some responsibility for the Pool, we were not entirely free of organizational impairments to independence in conducting our work. Accounting standards require we disclose this impairment. We limited our review to those areas specified in Note 1. In our opinion, the impairment does not affect our ability to conduct an independent audit.

This report is intended solely for the information and use of the Board of Supervisors, the Treasurer's management, and others within the organization and is not intended to be and should not be used by anyone other than these specific parties. However, this report is a matter of public record and its distribution is not limited.



Noriaki Hirasuna, CPA
Director of Financial Audits

November 27, 2006

Staff: Elisa Sullivan, Audit Manager
Vivian Chu
Nneka Gallaread
Winnie Woo

CITY AND COUNTY OF SAN FRANCISCO INVESTMENT POOL
STATEMENT OF NET ASSETS
JUNE 30, 2006

	Total
ASSETS	
Cash	
Cash on Hand	\$ 6,780
Cash in Bank	<u>16,086,163</u>
Total Cash	<u>16,092,943</u>
Investments at Fair Value	
U.S. Treasury Bills	334,333,615
U.S. Treasury Notes	1,058,971,875
Federal National Mortgage Association Discount Notes (FMNA Discount Notes)	211,861,428
Federal Home Loan Bank Discount Notes (FHL Discount Notes)	253,868,830
Federal Home Loan Mortgage Corporation Discount Notes (FMC Discount Notes)	335,108,742
Commercial Paper	812,472,232
Negotiable Certificates of Deposit	639,894,921
Public Time Deposit	<u>4,934,144</u>
Total Investments	<u>3,651,445,787</u>
Accrued Interest Receivable	<u>23,650,328</u>
Total Assets	3,691,189,058
LIABILITIES	
Outstanding Checks	77,614,045
Distributions Payable	<u>23,650,328</u>
Total Liabilities	101,264,373
NET ASSETS	\$ 3,589,924,685

See Accompanying Notes to the Basic Financial Statements

**CITY AND COUNTY OF SAN FRANCISCO INVESTMENT POOL
STATEMENT OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2006**

	Total
ADDITIONS	
Additions to Investment Pool	\$ 69,373,178,980
Investment Income:	
Net Decrease in Fair Value of Investments	(4,056,117)
Interest	131,674,588
Total Investment Income	127,618,471
Total Additions	69,500,797,451
DEDUCTIONS	
Deductions from Investment Pool	68,618,964,271
Distributions to Participants	113,358,224
Administrative Expenses	<u>5,953,008</u>
Total Deductions	68,738,275,503
Change in Net Assets	762,521,948
Net Assets, Beginning of Year	2,838,689,710
Prior Period Adjustment	(11,286,973)
NET ASSETS, END OF YEAR	\$ 3,589,924,685

See Accompanying Notes to the Basic Financial Statements

NOTES TO THE BASIC FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The City and County of San Francisco (City) Investment Pool (Pool) is a local government investment pool with approximately \$3.6 billion in net assets as of June 30, 2006. As the banker, tax collector, collection agent, and investment officer for the City, the Office of the Treasurer and Tax Collector (Treasurer) manages the Pool on behalf of most funds of the City and external participants. Investments made by the Treasurer are regulated by the California Government Code and by the City's investment policy approved annually by the City's Treasury Oversight Committee and the Board of Supervisors.

These basic financial statements present only the cash on hand, cash in bank, investments, and related activity under the control and accountability of the Treasurer of the City. The financial statements are not intended to present fairly the financial position and results of operations of the Treasurer or of the City.

The table below identifies the investment types that are authorized by the City's investment policy. The table also identifies certain provisions of the City's investment policy that address interest rate risk, credit risk, and concentration of credit risk. The investment policy provides additional restrictions related to these investments. Investments held by the Treasurer during the year did not include repurchase agreements or reverse repurchase agreements.

TABLE 1

Types of Investments Authorized By the City's Investment Policy

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
U.S. Treasury Bills	N/A	None	None
U.S. Treasury Notes	N/A	None	None
U.S. Treasury Bonds	N/A	5%	None
U.S. Agency Securities	N/A	60%	None
Commercial Paper	180 days	40%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Public Time Deposit	1 year	None	None
Public Demand Accounts	N/A	None	None
Bankers Acceptances	180 days	40%	30%
Repurchase Agreements	30 days	None	None
Reverse Repurchase Agreements	45 days	None	\$75MM

The Statement of Net Assets and the Statement of Changes in Net Assets are prepared using the economic resources

NOTES TO THE BASIC FINANCIAL STATEMENTS

measurement focus and the accrual basis of accounting. Earnings on investments are recognized as revenue in the period in which they are earned and administrative costs are recognized as expense when incurred, regardless of the timing of cash flows. Pool participants' cash balances and withdrawals are based on book value while investments are reported at fair value.

The Treasurer's Pool includes pooled deposits and investments, and dedicated investment funds. The dedicated investment funds represent restricted funds and relate to bond issuance of the City's enterprise funds and the City's general fund's cash reserve requirement. The Pool also includes both involuntary and voluntary participation from external entities. The State of California statutes require certain special districts and other governmental entities to maintain their cash surplus with the Treasurer. The San Francisco Unified School District (school district), the San Francisco Community College District (community college district), and the City are involuntary participants in the City's Pool. As of June 30, 2006, involuntary participants accounted for approximately 94 percent of the Pool. Voluntary participants accounted for 6 percent of the Pool.

Further, the school district, community college district, and the Trial Courts of the State of California are external participants of the City's Pool. At June 30, 2006, \$547 million was held on behalf of these external participants. The total percentage share of the City's Pool that relates to these three external participants is 15 percent. Internal participants accounted for 85 percent of the Pool. During the fiscal year ended June 30, 2006, the Treasurer has not entered into any legally binding guarantees to support the participant equity in the Pool. Further, the Pool is not registered with the SEC as an investment company.

All investments are carried at fair value. The fair value of pooled investments is determined annually and is based on current market prices. The fair value of participants' position in the Pool is the same as the value of the Pool shares. The method used to determine the value of participants' equity withdrawn is based on the book value of the participants' percentage participation at the date of such withdrawal. In the event that a certain fund overdraws its share of pooled cash, the overdraft is reported as a due to the general fund.

Income from pooled investments is allocated at month-end to the individual funds or external participants based on the fund or participant's average daily cash balance in relation to the total pooled investments. City management has determined that the investment income related to certain funds should be allocated to the general fund. On a budget basis, the interest income is recorded in the City's general fund. On a generally accepted

NOTES TO THE BASIC FINANCIAL STATEMENTS

accounting principles (GAAP) basis, the income is reported in the fund where the related investments reside. A transfer is then recorded to transfer an amount equal to the interest earnings to the general fund.

It is the City's policy to charge interest at month-end to those funds that have a negative average daily cash balance. In certain instances, City management has determined that the interest expense related to the fund should be allocated to the City's general fund. On a budget basis, the interest expense is recorded in the general fund. On a GAAP basis, the interest expense is recorded in the fund and then a transfer from the general fund for an amount equal to the interest expense is made to the fund.

The types of investments made during the year were substantially the same as those held as of June 30, 2006. Fair value fluctuates with interest rates and increasing rates could cause fair value to decline below original cost. City management believes the liquidity in the portfolio is sufficient to meet cash flow requirements and to preclude the City from having to sell investments below original cost for that purpose. The earned yield, which includes net gains on investments sold, on all investments held by the Treasurer for the fiscal year ending June 30, 2006 was 4.19 percent.

In accordance with California Government Code, Section 27136, any requests from agencies to withdraw funds from the investment pool for purposes other than cash flow, such as for external investing, is subject to the consent of the Treasurer. Those requests are subject to the Treasurer's consideration of the stability and predictability of the pooled investment fund, or the adverse effect on the interests of the other depositors in the pooled fund. Withdrawals are at the value shown on the Office of the Controller's books as of the date of withdrawal. Receivables consist of interest accrued on investments. The payables consist of outstanding checks and distributions payable.

2. Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Treasurer manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

All security transactions, including collateral for repurchase agreements, entered into by the Treasurer is conducted on a delivery-versus-payment basis pursuant to approved custodial

NOTES TO THE BASIC FINANCIAL STATEMENTS

safekeeping agreements. Securities will be held by a third party custodian designated by the Treasurer and evidenced by safekeeping receipts. Information about the sensitivity to the fair values of the Treasurer's investments to market interest rate fluctuations is provided by the following table, which shows the distribution of the Treasurer's investments by maturity.

TABLE 2

Pooled Investments by Maturity (in thousands)

Investment Type	Interest Rates	Maturities	Par Value	Fair Value (a)	Investment Maturities (in Months)				
					Under 1	1-6	6-12	12-36	36-60
U.S. Treasury Bills	4.53%-5.16%	7/6/06-12/21/06	\$342,000	\$334,334	\$36,793	\$297,540	-	-	-
U.S. Treasury Notes	4.42%-5.02%	11/15/06-3/31/08	1,070,000	1,058,972	-	494,687	\$49,289	\$514,995	
FNMA Discount Notes	4.94%-5.20%	7/17/06-2/23/07	215,000	211,861	148,975	14,812	48,074	-	-
FHL Discount Notes	4.85%-5.12%	7/5/06-8/9/06	255,000	253,869	243,950	9,918	-	-	-
FMC Discount Notes	4.85%-5.21%	7/11/06-12/29/06	340,000	335,109	148,621	186,487	-	-	-
Commercial Paper	5.00%-5.32%	7/5/06-8/22/06	820,000	812,472	609,533	202,939	-	-	-
Negotiable C.D.'s	5.02%-5.28%	7/3/06-8/23/06	640,000	639,895	449,931	189,964	-	-	-
Public Time Deposits	3.00%-5.40%	7/16/06-6/6/07	5,200	4,934	100	98	4,736	-	-
Total Investments:			\$3,687,200	\$3,651,446	\$1,637,903	\$1,396,449	\$102,099	\$514,995	

(a) The fair value amounts do not include accrued interest (in thousands) of \$21,137, \$10,844 of which is fixed income assets accrued earnings.

3. Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Table 3 shows the minimum rating required by the California Government Code and the City's investment policy and the actual rating as of June 30, 2006 for each investment type.

TABLE 3

Minimum Rating Required by the California Government Code and Investment Policy

Investment Type	Minimum Legal Rating	Standard & Poor's Rating	Total Investment Portfolio
U.S. Treasury Bills	N/A	A-1	9%
U.S. Treasury Notes	N/A	A-1	29%
U.S. Agencies	N/A	A-1	22%
Commercial Paper	A-1	A-1	22%
Negotiable C.D.s	N/A	A-1	18%

In addition, the Treasurer's investments in some public time deposits are not rated. The City's investment policy contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. U.S. Treasury and Agency securities are not subject to these single issuer limitations. As shown in Table 3 above, investments in U.S. Agencies that represent 5 percent or more of the total Pool are in the following: Federal National Mortgage Association Discount Notes, Federal Home Loan Bank Discount Notes, and Federal Home Loan Mortgage Corporation Discount Notes. These investments represent 6 percent, 7 percent, and 9 percent, respectively. Investments in commercial paper are with Bank of America, U.S. Bank, and Union Bank, with Bank of America representing 15 percent of the total 22 percent investment in commercial paper. Negotiable certificates of deposit are with Wells Fargo Bank and Bank of America, with Wells Fargo Bank representing 11 percent of the total 18 percent investment in negotiable certificates of deposit.

4. Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the City will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments; however, it is the practice of the Treasurer that all investments are insured, registered, or held by the Treasurer's custodial agent in the City's name.

The California Government Code requires California banks and savings and loan associations to secure the City's deposits not covered by federal deposit insurance by pledging government securities as collateral. The fair value of pledged securities must equal at least 110 percent of the type of collateral authorized in California Government Code, Section 53651 (a) through (l) of the City's deposits. The collateral must be held at the pledging bank's trust department or another bank, acting as the pledging bank's agent, in the City's name. The investment policy states that mortgage-backed collateral will not be accepted. At June 30, 2006, all of the banks with funds deposited by the Treasurer secure deposits with sufficient collateral.

NOTES TO THE BASIC FINANCIAL STATEMENTS

5. Investment Policy

The City's investment policy addresses the soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The objectives of the policy, in order of priority, are safety, liquidity, and yield. The City has established a Treasury Oversight Committee, comprised of various City officials and representatives of agencies with large cash balances, to monitor and review the management of public funds maintained in the investment pool in accordance with Sections 27130 to 27137 of the California Government Code. The Treasurer prepares and submits a comprehensive investment report to the Mayor, the Board of Supervisors, members of the Treasury Oversight Committee, and the Pool participants every month. The report covers the type of investments in the Pool, maturity dates, par value, actual cost, and fair value.

Although the California Government Code and the City's investment policy do not limit the amount of City funds that may be invested in U.S. Treasury bills and notes, the investment policy restricts purchases of treasury bonds to a maximum of five percent of the total portfolio at the time of purchase. Further, the California Government Code does not limit the amount of City funds that may be invested in federal agency instruments. However, the City's investment policy requires that investments in federal agencies should neither exceed 60 percent of the total portfolio at the time of purchase nor have a weighted average maturity in excess of 270 days. If it exceeds 270 days, the total should not exceed 30 percent of the total par value of the portfolio. The investment policy also limits each type of agency instrument.

The City's investment policy also limits the purchase of negotiable certificates of deposit to the five largest domestic commercial banks that have demonstrated profitability in their most recent audited financial statements at the time of purchase. In addition, the investment policy requires that public time deposits be made only at approved financial institutions with at least one full service branch within the geographical boundaries of the City, and that the deposits yield a minimum of 0.125 percent higher than equal maturity U.S. Treasury instruments except in special circumstances specifically authorized by the Treasurer. The investment policy restricts exposure to \$100,000 for all savings institutions and requires that each deposit be fully guaranteed by the Federal Deposit Insurance Corporation (F.D.I.C.). The investment policy also requires that commercial bank deposits be made on a competitive basis with risk exposure based on financial statements and related information gathered on each individual bank.

NOTES TO THE BASIC FINANCIAL STATEMENTS

Also, the California Government Code requires that the Treasurer purchase only domestic commercial paper with maturities not to exceed 270 days and that the issuer must be rated in the highest ranking by at least one of the national rating agencies. However, the Treasurer's investment policy is more restrictive in that it requires that the Treasurer purchase only domestic commercial paper with maturities not to exceed 180 days.

6. Prior Period Adjustment In the current fiscal year, a prior period adjustment is reported on the Statement of Changes in Net Assets to correct an error on the prior year financial statements. The net assets at the beginning of this fiscal year were overstated by \$11,286,973, because the prior year's Statement of Net Assets did not report a corresponding liability for the accrued interest receivable of \$11,286,973.

7. Safekeeping Items The Treasurer also holds for safekeeping bequests, trust funds, and lease deposits for other city departments. The bequests and trust funds consist of stocks and debentures. Those instruments are valued at par, cost, or market value at the time of donation. The following table summarizes the bequests, trusts, and lease deposits held by the Treasurer.

TABLE 4

Bequests, Trusts, and Lease Deposits Held by the Treasurer

Safekeeping Items	Amount
Bequests and Trusts	
San Francisco General Hospital	
Augusto Brunetti Bequest	\$ 166
Laguna Honda Hospital	
William L. Lenahan	207,478
Marie Lewis Gift Fund	72,336
Hazel I. Putnam	1,227
Miscellaneous Gift Fund	118,863
Recreation and Park Department	
Gilliland Bequest	182,364
Mildred Martin Bequest	7,182
Department of Human Services	
Mary Arcuri Account	2,163
Federal Home Loan Bequest	392
War Memorial	
P.P.I.E. Scholarship	5,000
Total Bequest and Trust Funds	\$ 597,171
Total Lease Deposits	\$ 26,658,046
Total Safekeeping Items	\$ 27,255,217

This report is intended solely for the information and use of management and others within the organization and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.



Noriaki Hirasuna, CPA
Director of Financial Audits
November 27, 2006

cc: Mayor
Board of Supervisors
Civil Grand Jury
Budget Analyst
Treasury Oversight Committee
Public Library

